

**Summary of Testimony of
Chairman James J. Hoecker
Federal Energy Regulatory Commission
before the
Subcommittee on Energy and Power
Committee on Commerce
United States House of Representatives**

October 5, 1999

Competition is growing in the electric generation and marketing sectors, in response to the Energy Policy Act of 1992 and the efforts of the Federal Energy Regulatory Commission to remove barriers to competition. Effective regulation of transmission facilities that are essential for delivering power is critical to ensuring that consumers continue to receive increasing benefits from competition in power markets. Likewise, effective restraints on the exercise of market power in these newly competitive electricity markets is essential to advancing competition.

I believe Congress should enact legislation to address several matters that are critical to achieving fully competitive, reliable wholesale electric power markets. These include placing all electric transmission in the continental United States under the same rules for non-discriminatory open access and comparable service; reinforcing the Commission's authority to foster regional transmission organizations; establishing mandatory reliability rules to protect the integrity of transmission service, relying on a self-regulating organization with appropriate Federal oversight of rule development and enforcement; providing the Commission with appropriate authority to remedy market power; and, reforming the Public Utility Holding Company Act (PUHCA). The provisions of H.R. 2944 advance many of these policy goals. However, my testimony recommends a number of additions and modifications. These suggestions in my testimony will help to ensure that H.R. 2944 achieves its laudable goals.

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Mr. Chairman and Members of the Subcommittee:

Good morning. My name is James J. Hoecker, Chairman of the Federal Energy Regulatory Commission. Thank you for the opportunity to appear before you today. My testimony will address the need for Federal electricity legislation generally and the provisions of H.R. 2944 in particular.

In prior testimony before this and other subcommittees of the House of Representatives, I have recommended that Congress enact legislation to address several matters that are critical to achieving fully competitive, reliable wholesale electric power markets. These include placing all electric transmission in the continental United States under the same rules for non-discriminatory open access and comparable service; reinforcing the Commission's authority to foster regional transmission organizations; establishing mandatory reliability rules to protect the integrity of transmission service, relying on a self-regulating organization with appropriate Federal oversight of rule development and enforcement; providing the Commission with appropriate authority to

remedy market power; and, reforming the Public Utility Holding Company Act (PUHCA).

As discussed below, the provisions of H.R. 2944 advance a number of these policy goals. I commend you, Chairman Barton, for developing this bill. I will suggest some additions and modifications for your consideration.

I. Introduction

Traditional regulation of electricity sales for resale in interstate commerce -- i.e., the wholesale or "bulk" power market -- has been based on the recognition that electric utilities were operating as natural monopolies. Consequently, during most of this century, federal agencies addressed market power and ratepayer interests, not by promoting competition, but by strict oversight of the terms of services and cost-of-service rates. In the 1980s and early 1990s, however, several developments in the electricity generation sector indicated that the interests of utility ratepayers could be better protected by competition in wholesale power markets than by cost-based regulation. The benefits of replacing traditional regulation with competition became evident in other industries, such as trucking, railroads, long-distance telecommunications and natural gas. In the Energy Policy Act of 1992, Congress took important steps toward competition in wholesale power markets, by providing the Commission with greater authority to order transmission owners to transmit power for other buyers and sellers in the wholesale market, and by modifying PUHCA to eliminate a key barrier for new generators entering

these markets. Electric generation units built and operated independently of traditional utilities had already proved to be competitive and reliable parts of the electric system.

Consistent with these changes in the industry, the Commission in 1996, through a major rulemaking called Order No. 888, ordered open, non-discriminatory access to the transmission facilities of public utilities for wholesale market participants. This open access obligation prohibits public utilities from discriminating against competitors' transactions in favor of their own wholesale sales of power. Order No. 888 has enhanced competition in wholesale power markets significantly, although it has not opened the grid to competition entirely.

Today, the promotion of competition and reliable service among power suppliers in wholesale markets remains the Commission's primary goal in this area. The Commission's fundamental regulatory objectives are: (1) to substitute competition for price regulation in wholesale power markets to the extent possible; and (2) to ensure that transmission service is made available under non-discriminatory terms and conditions so as to enable competition among suppliers of electricity in these markets. Transmission facilities form an integrated, interstate grid that is essential for delivering power, in the same way the interstate highway system allows trucks to deliver other commodities across state boundaries pursuant to private contracts. The transmission grid, however, is owned by individual utilities and, absent regulation, these utilities can effectively prevent the use of these facilities by their competitors. Thus, regulation of transmission is necessary to ensure open access, non-discrimination and reasonable rates. Effective

regulation of the relatively small transmission portion of the utility business (it accounts for about only three to four percent of the average price of energy delivered to the home) enables competition in the much larger generation sector to produce sizeable ratepayer benefits.

The Commission is seeking to use its current authority to promote competitive wholesale markets. The Commission has also made a determined effort to assist states choosing to pursue retail market competition, which ultimately will succeed only if there is a competitive wholesale market. However, most of the federal regulatory framework dates from before competition became significant in this industry and, in some key respects, now impedes these efforts. I therefore support Federal legislative reforms that will better enable the Commission to promote competition and reliability in wholesale markets as well as facilitate retail competition initiatives, as appropriate.

II. Transmission Issues

A. Open Access

Fair and open access to reliable transmission service is an essential predicate to competition in bulk power markets. Congress expressly recognized this fact in the Energy Policy Act of 1992, by giving the Commission limited new authority under Federal Power Act (FPA) section 211 to require utilities to provide transmission service to others on a case-by-case basis. The Commission later, in Order No. 888, relied primarily on its traditional authority to prevent undue discrimination when it ordered public utilities to provide generic open access to their transmission facilities. The

Commission concluded that Order No. 888 was necessary to support competition in wholesale power markets.

I view **Section 102(a)(1)** of H.R. 2944 as a confirmation that the open access provisions of Order No. 888 are completely consistent with Congressional goals. H.R. 2944 would clarify the Commission's authority to require open access transmission services under FPA sections 205 and 206, and would apply this clarification to any "rule or order promulgated by the Commission before, on, or after" the bill's enactment. I support this provision as eliminating any remaining uncertainty about the Commission's authority to adopt the Order No. 888 open access transmission requirements.

H.R. 2944 would extend the Commission's open access authority to all "transmitting utilities," as defined by the FPA. Under current law, the open access obligations of Order No. 888 apply only to transmission facilities owned or operated by "public utilities," as defined by the FPA. In other words, approximately one-third of the transmission grid in the contiguous 48 States is not subject to the Commission's open access requirements, even though these facilities are generally integrated with, and are integral to the operation of, the rest of the network. This portion of the grid is owned primarily by federally-owned utilities, electric cooperatives that are financed by the Rural Utilities Service, and some municipal utilities. While some of these entities have chosen to offer open access transmission service voluntarily, many others do not. These gaps in open access to the transmission grid inevitably impede the development of fully

competitive wholesale power markets. Only federal legislation making all utilities subject to the same open access requirements can remedy this problem.

I believe that all transmitting utilities should be subject to the same transmission rules. Open access to a seamless transmission grid by all electricity suppliers is essential if the Congress and the Commission intend to guarantee that buyers and sellers of electricity have as many choices as possible. I note, however, that H.R. 2944 narrows the definition of transmitting utilities to exclude certain utilities that transact within the Electric Reliability Council of Texas (ERCOT). While the Commission does not have authority to regulate transmission within ERCOT as it does elsewhere, it has had authority since 1978 to order transmitting utilities, including those that transmit within ERCOT, to provide transmission services in some circumstances under FPA section 211. Although used sparingly, this authority has been used to promote competitive access. *Central Power & Light Co., et al.*, 17 FERC ¶ 61,078 (1981); *City of College Station, Texas*, 86 FERC ¶ 61,165 (1999); *Tex-La Electric Cooperative of Texas, Inc.*, 69 FERC ¶ 61,269 (1994). The proposed change in definition would exempt those utilities that transact only within ERCOT from the current, limited section 211 authority as well as the broader open access authority addressed in H.R. 2944 itself. The Congress should leave the Commission with section 211 authority in this area.

B. Regional Transmission Organizations

In Order No. 888, the Commission encouraged, but did not require, the formation of independent system operators (ISOs). The Commission found that ISOs would promote broader, regional power markets and provide greater assurance of non-discrimination. Since 1996, six ISOs have been established (in California, the mid-Atlantic states, New England, New York, the Midwest, and Texas). Four of these are currently operational.

The Commission is now seeking to address the remaining impediments to full competition, which fall largely into two categories. First are the engineering and economic inefficiencies inherent in the current operation and expansion of the transmission grid. For example, each separate transmission operator makes independent decisions about the use, limitations, and expansion of its part of the grid, but the interconnection of the separate transmission systems causes each such action to immediately affect other parts of the grid. With the increase in competition, the grid is being stressed by many new entrants and by new transactions using two or more systems in a region, presenting challenges to the historical approach to maintaining the reliability of separate, but interconnected, systems. Also, competitive markets must evolve into regional markets if they are to thrive, and the efficiency gains of competitive markets will be imperiled unless regional solutions are used for pricing transmission services and managing regional constraints and expansion needs.

The second category of impediments are the continuing opportunities for transmission owners to unduly discriminate in the operation of their transmission systems so as to favor their own or their affiliates' power marketing activities. In the wake of Order No. 888, many market participants continue to allege, and the Commission has in some cases confirmed, that transmission service problems related to discriminatory conduct remain.

To address these impediments, the Commission has proposed new rules to promote the voluntary formation of regional transmission organizations (RTOs) such as ISOs and independent companies that own and operate only transmission facilities (transcos). Such institutions are encouraged to form in the near future, under a schedule specified in the proposal. Notice of Proposed Rulemaking on Regional Transmission Organizations, 64 Fed. Reg. 31,389, FERC Stats. & Regs., ¶ 32,541 (1999).

An RTO is an organization formed to administer the operation of the transmission system on behalf of all the participants in the market. It may be a for-profit or non-profit institution but it must be independent of all other financial interests of power market participants. It should cover an appropriately configured region and have adequate operational control over the transmission grid. If properly designed, an RTO can ensure the non-discriminatory operation of the transmission grid, eliminate pancaked transmission charges for using transmission systems owned by different utilities, reduce and better manage congestion on the transmission lines, and facilitate transmission planning on a multi-state basis.

Section 103 of H.R. 2944 would require each transmitting utility to establish or join an RTO by January 1, 2003, and to file an application for its proposed action with the Commission by January 1, 2002. I fully support the bill's goal of having utilities participate in an RTO.

However, I offer the following suggestions for improving H.R. 2944's provisions on RTOs. First, I would advance the deadline for participation in RTOs by at least one year, so that consumers can begin receiving the substantial benefits of RTOs much sooner. Because transmission systems are already regionally integrated, economic efficiency gains from the coordinated operation of transmission over a broad geographic area are readily attainable. It is therefore increasingly difficult to justify delaying such benefits to the public. The Commission's RTO proposal calls for RTOs to be operational by December 15, 2001.

Second, let me address proposed FPA section 202(h)(2), which addresses the standards RTOs must meet. Although the topics of the four standards proposed for FPA section 202(h)(2) -- independence, geographic scope and configuration, operational authority and expansion -- are generally consistent with key considerations identified in the Commission's proposed rule, I believe the bill should not attempt to codify detailed prescriptions for each of the four policy standards. The Commission has yet to evaluate all of the comments submitted on its proposed rules. As importantly, competitive markets will continue to evolve in ways that are difficult to predict. Detailed standards that appear appropriate today may be inappropriate in future years. For example, the bill

"deems" the requirement for independence to be met when market participants own passive, nonvoting interests or 10 percent or less of the voting interests. It is not appropriate to lock the details of these standards into statutory text, given the possible need to adapt the standards to future changes in the industry before the FPA is again modified. I recommend a somewhat different approach; namely, that the Congress should preserve the Commission's discretion to adapt policy to changing circumstances, especially with respect to administering the key policies of independence and regional scope and configuration. The Commission as well as the institutions we regulate need the ability to adapt to changing market conditions and to changing regional needs.

Third, under Section 103 of H.R. 2944, the Commission must approve an application to join or establish an RTO if the RTO meets the prescribed standards. It specifically prohibits the Commission from requiring a utility to participate in a different RTO. Although I believe the Commission must and will apply standards fairly and promptly, the language in the bill could be construed as allowing the Commission only to approve or disapprove an application, but not to modify it. To ensure that RTOs yield their expected benefits as soon as possible, and consistent with the Commission's authority under other FPA sections, such as sections 203, 205 and 206, the Commission should have the procedural flexibility to work with the applicants to modify a flawed proposal, instead of simply disapproving a deficient or non-complying application and thereby imposing the burden of reapplication. Further, the concept of RTOs, while sound, is a work in progress and the Commission should be able to approve such

applications subject to conditions when necessary to make them consistent with the public interest.

Finally, Section 103 of H.R. 2944 states that "[t]he Commission shall encourage incentive transmission pricing policies" for RTOs. Section 103 states that such pricing policies include incentives for transmitting utilities to form RTOs, as well as incentives for RTOs to eliminate rate pancaking, to minimize cost shifting and to encourage adequate investment in and expansion of the transmission grid. I support these goals. The Commission has already solicited comment on whether and how to employ such incentives in the context of the ongoing RTO rulemaking.

C. Reliability

The changes in the industry in recent years have created a need for new tools for ensuring the reliability of the transmission grid. In the past, reliability was addressed through the voluntary cooperation of transmission owners. Today, industry participants increasingly recognize that cooperative efforts among transmission-owning utilities may not be sufficient in a competitive environment, and that a mandatory system for ensuring the reliability of the grid is needed. This recognition has caused the industry to begin seeking the Commission's involvement on reliability issues, even though the Commission has not regulated system reliability historically and it has no express authority to do so. For example, while the Commission has authority to address discrimination in jurisdictional transmission services, it has no explicit statutory role in setting or reviewing

particular reliability standards or in ensuring the security of the electrical system or the adequacy of supply. That was left largely to the industry and the States.

As I have testified previously, Congress should make compliance with appropriate reliability standards mandatory. There appears to be an industry consensus that it can continue to work collaboratively to develop reliability standards, using a process in which all market sectors are fairly represented. I believe that, if the standard-setting process is representative of all stakeholders, a high degree of self-regulation is appropriate. However, sufficient Federal oversight will be needed to ensure that the standards set by that process are adequate, not unduly discriminatory or anticompetitive, and enforceable, and to ensure that enforcement of the standards is effective and fair.

Section 201 of H.R. 2944 meets these reliability concerns. Section 201 also recognizes the role of the States in ensuring the reliability of local distribution facilities by preserving existing State authority over local distribution facilities unless the exercise of such authority would unreasonably impair the reliability of the bulk power system. I believe that any Federal legislation should also preserve for the States any reliability practices that they have historically engaged in with respect to bundled transmission in their jurisdictions, provided that such practices are consistent with the applicable regional or national standards and such reliability practices do not unduly impair competition in bulk power markets.

D. Undue Discrimination and Comparability

In Order No. 888, the Commission required public utilities to offer transmission service to third parties under the same rates, terms and conditions as the utilities applied to themselves for their own wholesale and retail sales of generation. Further, load-serving utilities thereafter were to take transmission service for their wholesale sales of generation under the same tariff as everyone else. In other words, the Commission required "comparability" of transmission services for a public utility and its transmission customers. Comparability is critical to ensuring that competition in power markets is not distorted by preferential or discriminatory transmission services.

A recent court decision may have placed a cloud on the Commission's ability to ensure comparability and support competition. The appellate court decision in Northern States Power Co., et al., v. FERC, No. 98-3000 (8th Cir., May 14, 1999, rehearing denied, September 1, 1999), if interpreted and applied broadly, may prevent the Commission from enforcing rules that provide for comparable terms and conditions of service for all users of transmission, including pro rata curtailments of transmission service used by a utility for in-state "native load." Arguably, this court decision may allow one state to require its utilities to establish a preference for in-state uses of the transmission grid to the detriment of consumers in other states whose utilities depend on comparable access to electricity supplies over the same transmission facilities. If states can effectively establish preferential transmission services for the utilities they regulate,

the wholesale power markets will become balkanized and competition in those markets could wither.

I suggest revising **Section 101** of H.R. 2944 to address this concern. In particular, I suggest adding a provision at the end of FPA section 201(a), as modified by **section 101(b)(1)** of the bill, stating that:

In regulating the transmission of electric energy under any provision of this Part [Part II of the FPA], the Commission shall have exclusive authority to establish rates, terms and conditions of transmission service that are just, reasonable and not unduly discriminatory or preferential, including rates, terms and conditions that prevent or eliminate undue discrimination or preference associated with a public utility's or transmitting utility's own uses of its transmission system to serve its wholesale and retail electric energy customers.

Such a provision would clarify the Commission's authority to ensure that transmission services within its exclusive jurisdiction are provided on a basis that is comparable to, i.e., no less favorable than, other transmission services provided by a transmitting utility, and that competition among power suppliers is not distorted.

E. Expansion of the Transmission Grid

Section 105 of H.R. 2944 would allow the Commission, upon application, to order a transmitting utility to enlarge, extend or improve its transmission facilities. Before doing so, the Commission would be required to refer the matter to a joint board for recommendations on the need for, design of, and location of the proposed expansion. The provision retains the states' traditional siting authority.

I do not see a current compelling need for the Commission to be given the authority specified in section 105 of H.R. 2944. Instead, my expectation is that RTOs will help address many issues concerning expansion of the transmission grid including the need for new facilities and who pays for them. However, even if an RTO were to recommend system expansion, nothing could be done without the cooperation or acquiescence of state siting authorities. Nothing in H.R. 2944 proposes to alter that.

III. Merger Review and Market Power

Under FPA section 203, the Commission must review proposed mergers, acquisitions, and dispositions of jurisdictional facilities by public utilities, and must approve such transactions if they are consistent with the public interest. In evaluating the public interest, the Commission considers a transaction's effects on competition, rates, and regulation.

The Commission's jurisdiction over mergers is currently limited in certain ways. First, the Commission has no direct jurisdiction over transfers of generation facilities. It can review transactions involving a public utility only when they involve other facilities that are jurisdictional (such as transmission facilities or contracts for wholesale sales). Second, the Commission lacks direct jurisdiction over mergers of public utility holding companies that have electric utility subsidiaries. While the Commission has construed such mergers to involve jurisdictional indirect mergers of public utility subsidiaries of the holding companies, or changes in control over the jurisdictional facilities of the public utility subsidiaries, the FPA is not explicit on this point. **Section 401** of H.R. 2944 would

address both circumstances appropriately, clarifying that the Commission has jurisdiction over transactions involving only generation facilities and mergers of holding companies.

I support these amendments.

Section 401 of H.R. 2944 also would require the Commission to act on mergers within five months or, for good cause shown, an additional three months. Since the Commission issued its Merger Policy Statement in December 1996, the Commission has taken final action on nearly all mergers within five months after receipt of a complete application. Those actions included review of complex electric and gas-electric mergers, some of them quite large and unprecedented. Therefore, I would expect the proposed deadlines to be adequate, with one caveat. Occasionally a merger raises numerous and genuine issues of material fact that necessitate extensive fact-finding in a hearing context. For example, out of the 30 merger applications filed since issuance of the Commission's Merger Policy Statement, the Commission has acted on 23 of them (the other seven having been filed only recently) and needed to establish an evidentiary hearing with respect to only three of them because there were material facts in dispute. In such cases, the Commission needs more time to resolve such factual disputes than H.R. 2944 would allow. In those infrequent instances when material facts are disputed, an artificially short deadline would leave the Commission with little recourse other than to reject the application.

I note that other pending legislation would enhance the Commission's authority to address market power outside the context of mergers. For example, the Administration's

proposed bill, H.R. 1828, would allow the Commission to address market power in retail markets, if asked to do so by a state lacking adequate authority to address the problem. It would also give the Commission explicit authority to address market power in wholesale markets by requiring a public utility to file and implement a market power mitigation plan. H.R. 2050, sponsored by Congressmen Largent and Markey, also contains provisions that would allow mitigation of market power, to the benefit of competition and consumers. Such provisions are particularly desirable in the circumstances where a State lacks adequate authority to address market power issues and seeks FERC's assistance. As the Commission moves toward light-handed regulation, its ability to monitor the market and to identify and address exercises of residual market power becomes more important.

IV. PUHCA

Adopted over 60 years ago to restrain the growth and power of large utility holding companies, PUHCA requires some utilities to comply with restrictions that are not entirely compatible with today's bulk power competition. In some instances, PUHCA encourages the very concentrations of generation ownership and control that undermine competitive power markets. It discourages asset combinations that could be pro-competitive. Thus, PUHCA should be reformed, with one major caveat. Reform legislation should ensure that both the Commission and States have adequate access to the books and records of utilities and their affiliates, to protect against affiliate abuse and

ensure that captive consumers do not cross-subsidize entrepreneurial ventures.

Sections 511-524 of H.R. 2944 would satisfy these concerns.

V. Conclusion

Competition is growing in the electric generation and marketing sectors, in response to the Energy Policy Act of 1992 and the Commission's efforts to remove barriers to competition. My objective in seeking legislation is to create a market structure that ultimately will allow markets – not regulators -- to determine the price of wholesale electric power. Effective regulation of transmission facilities that are essential for delivering power is critical to ensuring that consumers continue to receive increasing benefits from competition in power markets. Likewise, effective restraints on the exercise of market power in these newly competitive electricity markets is essential to advancing competition.

Thank you again for the opportunity to offer my views here this morning. I would be pleased to answer any questions you may have.